United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

Signed

76-4014

IN THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

ALFRED H. TURECAMO and FRANCES M. TURECAMO,

Appellees

v.

COMMISSIONER OF INTERNAL REVENUE,

Appellant

ON APPEAL FROM THE DECISION OF THE

UNITED STATES TAX COURT

BRIEF FOR THE APPELLANT

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STATEMENT OF THE ISSUE PRESENTED

Whether the Tax Court majority erred in holding that Basic Medicare hospitalization benefits received under Title XVIII, Part A of the Social Security Act, should not be treated like old age, disability and survivors benefits received as social insurance under Title II of the Social Security Act, but should instead be treated like private medical insurance benefits; and thus accordingly also erred in concluding that the Basic Medicare benefits should not be treated as support furnished by the Medicare recipient for purposes of the

Long Island, New York, and was discharged from that hospital on October 9, 1970. The hospital charges for her stay in the hospital amounted to $11,095.75, of which $10,434.75 were satisfied by "Medicare allowances." These benefits were payments made pursuant to the Health Insurance for the Aged Act, P.L. 89-97, 79 Stat. 290, which added Title XVIII to the Social Security Act, c. 531, 44 Stat. 620 (42 U.S.C.), along with amendments to Title II of the Social Security Act and amendments to the social security tax provisions of the Internal Revenue Code. More specifically, the Basic Medicare benefits paid on Mrs. Kavanaugh's behalf and in issue here were disbursed pursuant to Sections 101 and 102 of P.L. 89-97 (particularly Part A of P.L. 89-97, Section 102(a)) (42 U.S.C. §§ 426, 1395-1395i)). Supplementary medical insurance payments made to or on behalf of Mrs. Kavanaugh under Part B of P.L. 89-97, Section 102(a) (42 U.S.C. §§ 1395j-1395w), and social insurance old-age benefits paid to her under Title II of the Social Security Act, old-age survivor and disability insurance (hereinafter "OASDI") are not in issue here.[2/]

2/ Mrs. Kavanaugh received $1,140 in Social Security OASDI payments in 1970 (R. 55). The Internal Revenue Service advises that at least $14.40 was also paid on Mrs. Kavanaugh's behalf as Part B Medicare Supplementary insurance benefits in that year.

In addition to these hospital costs, Mrs. Kavanaugh's condition was such that nursing care was required, the total cost for such nursing services being paid by the taxpayers. In 1970 the taxpayers paid $4,531 for hospital and nursing care for Mrs. Kavanaugh. In addition, the taxpayers provided Mrs. Kavanaugh with two and one-half rooms in their home during 1970, which she used as her apartment. The taxpayers provided a telephone in these rooms for Mrs. Kavanaugh's benefit, as well as the rooms' furnishings, including a television set. The taxpayers also provided Mrs. Kavanaugh's meals, some clothing, and occasional entertainment. The total amount contributed by the taxpayers towards Mrs. Kavanaugh's support through the furnishing of an apartment, food, clothing, and entertainment was approximately $4,000. (R. 55.)

On their 1970 federal income tax returns, the taxpayers claimed a dependency exemption for Mrs. Kavanaugh, and also claimed $3,531 as deductible medical expenses which they paid on Mrs. Kavanaugh's behalf in that year. Since the total medical expenses claimed by the taxpayers amounted to $4,017, they subtracted $674 (representing three percent of their reported adjusted gross income), and claimed a medical deduction of $3,343. The Commissioner disallowed the claimed dependency exemption for Mrs. Kavanaugh, as well as the medical expenses deduction, asserting that the taxpayers had not established that Mrs. Kavanaugh qualified as their dependent, under Sections 151 and 152 of the

Internal Revenue Code of 1954.[3] The basis for this determination was that the $10,434.75 in Basic Medicare benefits was held to be support furnished by Mrs. Kavanaugh. (R. 56-57.)

The Tax Court, in a reviewed opinion, three judges concurring and four judges dissenting, rejected the Commissioner's distinction, announced in Rev. Rul. 70-341, 1970-2 Cum. Bull. 31, that benefits paid under Part A of Title XVIII of the Social Security Act should be treated as received by the recipient for her own support, whereas only premiums paid by the insured under Part B of Title XVIII of the Social Security Act should be treated as having been paid by the insured for her own support. The majority reasoned that the Commissioner had ruled that the benefits received under Part B of Title XVIII of the Social Security Act should not be included in the amount treated as having been paid by the insured for her own support; that there was no rational basis for distinguishing Basic Medicare Part A from the Supplementary Insurance Part B benefits; and, accordingly, that the Part A benefits received by Mrs. Kavanaugh should not be treated as having been received by her for her own support. As a result, the majority ruled that the

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3/ The Commissioner also disallowed a casualty loss claimed by the taxpayers for damage done to their automobile. The Tax Court allowed this deduction. The Commissioner does not appeal from this determination.

the $10,434.75 of Part A benefits paid by the Government for Mrs. Kavanaugh's benefit in 1970 should be ignored for support purposes and that the taxpayers had therefore provided more than one half of Mrs. Kavanaugh's support in that year and were entitled to a dependency exemption for her, and to deduct her medical expenses paid for by the taxpayers in that year.

The concurring opinion agreed with the majority's conclusion that Part A and Part B benefits were inseparable, but stated that even if the two programs were in fact distinguishable, the Commissioner was in error in analogizing Part A benefits with OASDI Social Security and other governmental benefits involved in prior cases, which had been held to be support attributable to the recipients in determining the right to a dependency exemption. The concurring opinion stressed that the Part A benefits were more like private health insurance proceeds, which the Commissioner had ruled should not be treated as support provided by the recipient, except to the extent of the premiums paid by the recipient.

Judges Tannenwald, Raum, Simpson and Quealy, dissenting, criticized (R. 93-94) the majority for "riding piggyback" on the Rev. Rul. 70-341 conclusion that Part B Supplementary Insurance benefits should be treated like private medical insurance benefits, instead of directly addressing the real issue regarding the Congressional intent and structure

embodied in Part A Basic Medicare. The dissent held (R. 95-96) that Part A benefits were comparable to OASDI social insurance benefits received under Title II of the Social Security Act, as well as similar other governmental benefits, which a long line of cases and rulings have consistently held to constitute support furnished by the beneficiaries.

From the Tax Court decision, the Commissioner prosecutes this appeal.

SUMMARY OF ARGUMENT

1. Code Sections 151 and 152 provide a dependency exemption for taxpayers who provide over half the support of certain relatives, including a mother or mother-in-law. Code Section 213 provides that a taxpayer may also deduct medical expenses paid on behalf of persons who are "dependents" within the meaning of Code Section 152. The issue here is whether taxpayers furnished over one-half of the support of their mother/mother-in-law so as to qualify her as their "dependent." This question in turn undisputably depends on whether over $10,000 in hospitalization benefits paid on the mother's behalf by the Federal Government under Basic Medicare (Part A of Title XVIII of the Social Security Act) should be treated as support furnished by the mother, which would result in taxpayers' furnishing less than one-half her support. The issue is of extraordinary importance to both the administration and collection of the federal revenues. The treatment of Government payments generally (and Medicare payments specifically) for support purposes arises yearly in millions of instances, and thus requires a uniform, consistent and easily administrable rule. Moreover, in view of their frequency of occurrence, the basic principles at issue here involve billions of dollars of revenue annually.

2. Because of administrative difficulties under the prior dependency exemption statute, the Internal Revenue Service has taken extraordinary care to develop uniform and

consistent support principles since the enactment of the predecessor of Code Sections 151 and 152 in 1944. The very next year, the Commissioner ruled that dependents' allotments paid by the Government to children of servicemen did not constitute support furnished by the parents. Thereafter, Regulations and numerous Rulings, together with many cases, have consistently held that other Government payments--such as GI Bill and welfare payments--constitute support furnished by the recipients rather than by their parents or other persons. Most pertinent here, the Regulations and Rulings have uniformly concluded that old age, survivors and disability social insurance payments ("OASDI" under Social Security Act Title II), made to the elderly, children, disabled and others constitute support furnished by such recipients for purposes of Code Sections 151, 152 and 213. By contrast, the proceeds of health insurance policies are disregarded when computing support, while health insurance premiums are deemed support furnished by the payor (such as the children of elderly parents).

3. The structure and legislative history of the Basic Medicare hospitalization benefits provided by Title XVIII, Part A and Title II, Section 226 of the Social Security Act clearly indicate that Congress deemed Basic Medicare to be an extension and form of OASDI social insurance provided by Title II of the same Act. The Administration and the Congressional majority on one side, and the minority on the other side,

clearly stated and recognized that Part A Basic Medicare represents Social Security social insurance in the traditional sense, and vigorously and sharply joined issue over its enactment on that basis throughout hundreds of pages of Congessional testimony and debate. Like OASDI, Part A Basic Medicare hospitalization benefits are financed by payroll taxes throughout a worker's lifetime, with benefits payable to all OASDI recipients. Indeed, at first Part A Basic Medicare constituted the Administration's entire medical-care-for-the-aged program; the elderly would be expected to obtain coverage for non-hospital costs with private supplemental insurance.

As a compromise, however, the final Administration-majority bill embodied both the Social Security social insurance pattern for Basic Medicare Part A hospitalization coverage, together with the Government-subsidized individual, voluntary insurance pattern pressed by the minority for the Part B non-hospitalization Supplementary Insurance coverage. The Social Security social insurance pattern was adopted for Part A hospitalization coverage because Social Security payroll taxes then constituted the largest available revenue source; hospitalization coverage was most expensive, but could be financed on a long-term basis because of firm actuarial data on hospital usage; and non-compulsory participation would have led to drop-outs of the best risks and would thus have been impracticable.

By contrast, Part B physicians coverage embodied the minority's medical coverage plan patterned after the federal employee medical insurance plans. The Part B non-hospitalization coverage was voluntary; required the covered elderly to contribute significant premiums supplemented by Government subsidies; was actuarily founded on short-term projections because of unpredictable physician services usage; and made payments through private insurance carriers on a reasonable fee (rather than cost) basis to preserve physician independence. The Congressional minority was unsuccessful in extending the Part B individual insurance pattern to hospitalization costs, however, despite their lengthy, heated and vigorous arguments that the Part A Social Security pattern for medical coverage would impose highly regressive taxes and would eventually bankrupt the Title II OASDI program.

4. The majority opinions below gravely erred in substantially ignoring this basic structure and intent comprising Parts A and B, and in overlooking that the Parts A and B forms, as well as their substance, constitute the law of the land. Instead, the majority opinions attempted to divine the purported "nature" and "character" of the Medicare Act, reasoning that the Act was an interrelated medical insurance program; that the Commissioner's Rulings conceded that Part B Supplementary Insurance payments constituted insurance proceeds and thus disregardable as support; and that therefore Part A Basic Medicare benefits must similarly

be treated as individual insurance benefits, rather than Government social insurance payments, for support purposes.

Initially, such a substance-over-form analysis is totally inappropriate for tax purposes--and has been rejected by the Supreme Court--when Congress itself by statute intends and effects separate forms, such as the Part A social insurance and the Part B individual insurance here. Secondly, the majority opinions' analysis ignores the explicit Congressional mandate that Part A taxes--like OASDI taxes--are not deductible medical premiums, thus logically requiring that the Part A benefits be viewed as social insurance payments rather than individual insurance proceeds. By contrast, the 1965 Medicare statute expressly provides a medical expense deduction for Part B Supplementary Insurance premiums, logically implying that Part B proceeds are individual medical insurance proceeds. Thirdly, the majority opinions brushed over the essential separateness of the Congressionally drafted Parts A and B financing devices, trust funds, actuarial bases, administrative procedures, and enrollment limitations. Instead, the majority mistakenly placed great emphasis on the fact that certain definitional statutes are common to both Parts A and B, all the while ignoring the 1965 Act's incorporation of several Title II OASDI definitions.

Finally, as the dissenting opinion below so strongly emphasized, the majority's approach fundamentally errs in blindly and totally embracing the Commissioner's Ruling

that Part B benefits constitute individual insurance proceeds, and then "riding piggyback" on that conclusion in holding that Part A benefits are part of the same general program and thus must also be treated as individual insurance proceeds rather than social insurance payments. Characterization of Part B benefits as individual insurance proceeds is a close question, due to factors such as the major Government control and subsidization thereof; in such circumstances, extrapolating a Part A analysis from the Part B conclusion is almost bound to--and did--yield a wrong legal conclusion.

ARGUMENT

THE TAX COURT MAJORITY LEGALLY ERRED IN HOLDING THAT BASIC MEDICARE HOSPITALIZATION PAYMENTS MADE BY THE GOVERNMENT ON BEHALF OF TAXPAYERS' MOTHER DID NOT CONSTITUTE SUPPORT ATTRIBUTABLE TO THE MOTHER FOR DEPENDENCY EXEMPTION PURPOSES

A. Introduction

This case involves the proper treatment of payments made by the Federal Government for hospitalization for taxpayers' mother/mother-in-law under Part A of the 1965 Health Insurance for the Aged Act ("1965 Act"), P.L. 89-97, 79 Stat. 290, which added Title XVIII to the Social Security Act, c. 531, 49 Stat. 620, Secs. 1801-1817 (42 U.S.C. §§ 1395-1395i). This issue also requires consideration of Section 101 of the 1965 Act, which prefaces and applies to Part A and adds Section 226 (42 U.S.C. § 426) to Title II of the Social Security Act, Sec. 201 et seq. (42 U.S.C. § 401 et seq.) relating to old age survivor and disability insurance ("OASDI"). Before turning to a detailed discussion of the 1965 Act, however, a brief outline of basic and settled dependency deduction principles under Sections 151 and 152 of the 1954 Internal Revenue Code, Appendix A, infra, is necessary.

B. The Sections 151 through 152 dependency exemption statutes and Regulations expressly require inclusion of all income -- including nontaxable federal Social Security insurance benefits -- as support furnished by the recipient

Section 151 of the Internal Revenue Code of 1954 and its predecessor, Section 25(b) of the Internal Revenue Code

of 1939,[4] allowed an individual to claim, in particular circumstances, a personal exemption of $600 for each "dependent." The latter term is defined by Section 152(a) of the Code as including, inter alia, the "mother" or "mother-in-law" of the taxpayer, so long as the taxpayer provided more than one half of such "dependent's" support in the taxable year. In addition, Section 213 of the Code, Appendix A, infra, permits a taxpayer a medical expense deduction, in certain circumstances, for amounts paid for the "medical care"[5] of the taxpayer, his spouse, and "dependents (as defined in Section 152)"[6].

4/ Section 25(b) was added by Section 10(b) of the Individual Income Tax Act of 1944, c. 210, 58 Stat. 231.

5/ Section 213(a) of the Internal Revenue Code states:

> (a) Allowance of Deduction.--There shall be allowed as a deduction the following amounts, not compensated for by insurance or otherwise--
>
> (1) the amount by which the amount of the expenses paid during the taxable year (reduced by any amount deductible under paragraph (2)) for medical care of the taxpayer, his spouse, and dependents (as defined in section 152) exceeds 3 percent of the adjusted gross income, and
>
> (2) an amount (not in excess of $150) equal to one-half of the expenses paid during the taxable year for insurance which constitutes medical care for the taxpayer, his spouse, and dependents.

6/ Section 213(e)(1)(C) of the Code defines "medical care" as including the amount paid "for insurance (including amounts paid as premiums under part B of title XVIII of the Social Security Act, relating to supplementary medical insurance for the aged) covering medical care".

In computing the amount which is treated as provided by an individual for his own support, for purposes of determining whether another has provided more than one half of such individual's support, the Regulations have long provided that "there must be included any amount which is contributed by such individual for his own support, including income which is ordinarily excludable from gross income, such as benefits received under the Social Security Act." Treasury Regulations on Income Tax (1954 Code) § 1.152-1(a)(2)(ii), Appendix A, infra. The general rule which the Commissioner has applied, then, is a practical and all-encompassing one, that "the entire amount of support which the individual received from all sources, including support which the individual himself supplied" (Treasury Regulations on Income Tax (1954 Code) § 1.152-1(a)(2)(i)[7], is to be attributed to the recipient, in determining whether someone else provided more than one half of such individual's support.

7/ Legislative history surrounding the enactment of the predecessor of Section 152 emphasizes the practical nature of the determination required under the statute, in its insistence that tying the right to the dependency exemption to the question of whether the dependent was "mentally or physically unable to support himself", as was the case under prior law, was "unnecessarily limited and confusing", whereas the new test permitted "a credit for dependents over 18 who are in fact supported by the taxpayer." (Emphasis supplied.) S. Rep. No. 885, 78th Cong., 2d Sess., p. 6 (1944 Cum. Bull. 958, 961.)

C. The cases and administrative rulings have long and consistently treated governmental payments and social insurance benefits as support furnished by the recipient

It is readily apparent that few principles in the Code have a more widespread impact on the tax liabilities of millions of American taxpayers than the Sections 151 and 152 principles. While dependency exemptions normally do not involve large sums for any particular taxpayer, their cumulative nationwide impact runs in the billions of dollars of tax revenue. For example, an effective $25 increase in the dependency exemption in 1971 (from $650 to $675) resulted in a revenue loss of $1,370,000,000 for 1971 alone. H. Rep. No. 92-533, 92d Cong., 1st Sess., p. 12 (Table 2) (1972-1 Cum. Bull. 498, 505). Because of the large revenues involved, and the particular need in this area to set forth rules which are uniform and easy to understand, the Commissioner has taken considerable pains to issue a long, consistent, and detailed set of administrative Rulings. See Code Sec. 7805 (26 U.S.C.).

In general, these Rulings attribute for support purposes any payments from state and federal authorities to the recipient if the payment can rationally be identified as having been paid for the recipient's support. For example, the Commissioner has long and consistently ruled that state welfare payments which pay for basic human necessities such as food and lodging are attributable to

the recipient on whose behalf the payments were made. Rev. Rul. 59-232, 1959-2 Cum. Bull. 52, superseded by Rev. Rul. 71-468, 1971-2 Cum. Bull. 115. This position has been approved in Lutter v. Commissioner, 61 T.C. 685 (1974), aff'd per curiam, 514 F. 2d 1095 (C.A. 7, 1975), cert. denied, 44 U.S. Law Wk. 3264 (Nov. 3, 1975), in which aid to dependent children under Subchapter IV of the Social Security Act, Sec. 401 et seq. (42 U.S.C. § 601 et seq.) was deemed to be attributable to the recipient children, rather than to their parent, in assessing whether such parent provided more than one half of the children's support. Accord, Donner v. Commissioner, 25 T.C. 1043 (1956) (state public welfare payments for the benefit of the taxpayer's invalid son); Newman v. Commissioner, 28 T.C. 550 (1957) (amounts paid to state institutions in which taxpayer had placed her niece and nephews were less than one half of value of services provided by institution to children, thus depriving her of dependency exemptions); and Carter v. Commissioner, 55 T.C. 109 (1970), acq., Rev. Rul. 71-468, 1971-2 Cum. Bull. 115 (state welfare payments would be counted as support furnished by recipient if recipient actually used such funds for her own support, but not if recipient used funds for other purposes). In addition, Lutter also held that medical payments made under Section 121(a) of the 1965 Act here in issue -- Title XIX of the Social Security Act (42 U.S.C. §§ 1396-1396g) -- to children receiving aid

to dependent children[8] relief, constituted support furnished by the recipient children, not their mother. (See R. 82-83.)

The Commissioner has not confined the situations in which payments by state or federal authorities shall be attributed to the recipient to those cases where the payment is based upon a showing of necessity. As early as 1945, shortly after enactment of the predecessor of Section 152, the Commissioner in a Special Ruling of March 14, 1945, 1945 C.C.H. Stand. Fed. Tax Rep., par. 6168, Appendix B, infra, ruled that a family allowance payable to the wife of a military serviceman under the Serviceman's Dependents Allowance Act of 1942,[9] was support furnished by the Government, rather than by the mother, for purposes of computing whether the mother had furnished over half of the child's support and was entitled to a dependency exemption for such child. Thus, the value of an appointment to the United States Military Academy is deemed to be support which must be taken into consideration in determining whether a parent has the right to claim a dependency exemption for a child attending that institution. Rev. Rul. 55-347, 1955-1 Cum. Bull. 21. Similarly, amounts

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8/ Cash payment to families under the Aid to Families with Dependent Children program are made under Title IV, Part A of the Social Security Act, Secs. 401-444, as amended (42 U.S.C. §§ 601-644), and a corresponding state program.

9/ c. 443, 56 Stat. 381, Sec. 101 et seq. (37 U.S.C. (1940 ed.), Supp. IV, § 201 et seq.)).

received by a person under the GI Bill must be considered in determining whether a parent has provided more than one half of the student's support. I.T. 3834, 1947-1 Cum. Bull. 29, declared obsolete, Rev. Rul. 72-146, 1972-1 Cum. Bull. 408.

Most important of all, it has been the Commissioner's uniform position that "Federal Old Age, Survivors, and Disability Insurance[10/]" benefits (OASDI) are counted as support furnished by the recipient, in determining the right to the dependency exemption. Thus, in Rev. Rul. 57-344, 1957-2 Cum. Bull. 112, the Commissioner ruled that OASDI insurance benefits paid to children of retired or deceased individuals under Title II, Section 202, of the Social Security Act (42 U.S.C. § 402) constituted support furnished by the child, rather than by the child's parent or guardian. And, in Rev. Rul. 58-419, 1958-2 Cum. Bull. 57, amplified by Rev. Rul. 64-222, 1964-2 Cum. Bull. 47, the same result was reached, when the Commissioner ruled that Section 202 Social Security insurance benefits received by an insured and his wife must be counted as support furnished by them for purposes of the dependency test.

10/ See the title of Title II of the Social Security Act, as amended (42 U.S.C.).

In summary, then, in determining whether an individual has provided more than one half of the support of another, the Commissioner has applied a rule of all-inclusiveness to the entire gamut of federal and state payments received by, or paid for, the benefit of particular individuals, attributing such payments to the beneficiaries regardless whether the item is nontaxable to the recipient (e.g., GI Bill benefits), whether the item is paid because of the recipient's contributions, or the contributions of a relative of the recipient (e.g., Social Security OASDI insurance benefits), or, finally, whether the item is paid as a result of the recipient's prior services (e.g., Social Security insurance benefits; GI Bill benefits).

D. The express Code Section 213 deduction for Medicare Part B premiums, coupled with the express nondeductibility of taxes which finance Part A Medicare, indicate that Part A and Part B benefits should be treated differently

In Rev. Rul. 70-341, 1970-2 Cum. Bull. 31, the Commissioner made an extensive analysis of the Medicare provisions of the Social Security Act, as they might affect particular tax questions, and came to the following conclusions. First, an analysis of the provisions of Part A of Title XVIII ("Basic Medicare") showed that the basic hospital insurance benefits provided for individuals 65 and older were -- like most Social Security Act payments -- financed largely by taxes, more particularly payroll taxes, paid by employers, employees and the self-employed. The

Commissioner determined that the benefits paid out under the Part A Basic Medicare program were "in the nature of disbursements made in furtherance of the social welfare objectives of the Federal Government."[11] He accordingly concluded that the taxes paid to fund the Part A trust were not deductible as health insurance premiums under Section 213 of the Code,[12] and that the Part A medical benefits -- like Title II OASDI benefits -- constituted support furnished by the recipient for Code Section 151 purposes:

> In computing the amount that is contributed to the support of the individual [for purposes of the Section 151-152 dependency exemption], there must be included any amount that is contributed by such individual for his own support, including amounts that are ordinarily excludable from gross income such as social security payments. For example, Revenue Ruling 57-344, C.B. 1957-2 112, holds that child insurance benefits under title II of the Social Security Act received and used for the support of a child are considered the child's contribution to his support in determining who furnished more than one half of the child's support. Likewise, it is held that basic medicare benefits received by (or on behalf of) an individual are includible as the individual's own contribution to his support in determining who provided more than one-half of his support.

11/ Accordingly, Social Security benefits paid under Title XVIII, like those paid out under Title II (42 U.S.C. § 402), were determined not to be includible in the recipient's income, citing Rev. Rul. 70-217, 1970-1 Cum. Bull. 13.

12/ Rev. Rul. 66-216, 1966-2 Cum. Bull. 100, had come to the same conclusion, based upon direct language found in H. Rep. No. 213, 89th Cong., 1st Sess., p. 179 (1965-2 Cum. Bull. 733, 745) and S. Rep. No. 404 (Part 1), 89th Cong., 1st Sess., p. 200 (1965-2 Cum. Bull. 758, 764) which mandated that conclusion.

Second, Rev. Rul. 70-341, supra, distinguished, however, the Supplementary Medical Insurance benefits provided under Social Security Act, Title XVIII, Part B, stressing that they were currently funded by those persons presently enrolled in the program, the Government contributing approximately an equal amount towards the cost of the program. Because the Commissioner had ruled in Rev. Rul. 66-216, supra, that Part B premiums were akin to health insurance premiums and thus medical expenses deductible under Section 213 of the Code, he felt obliged to rule that only the premium cost, rather than the total health benefits received by the beneficiary, should be included for support purposes under Sections 151 and 152 in the amount contributed by the person making the Part B payments. This Ruling accorded with the usual treatment of health insurance premiums for purposes of Code Sections 151, 152 and 213, and in particular was designed to prevent Part B premium payors, like medical insurance policyholders, from counting both the insurance premiums and the insurance proceeds as support or deductions, thus in effect doubling their tax benefits.[13/]

13/ Ordinarily, one is not entitled to count as "support" insurance payments which one makes for the benefit of an alleged dependent. For example, premiums which a policyholder pays for life insurance, either on one's own life or on the life of the alleged dependent, payable to such dependent, cannot be counted as support paid by the policyholder to the alleged dependent since the policyholder

(Continued)

On its face, then, Rev. Rul. 70-341 contains a persuasive inherent logic and symmetry in determining the treatment of Part A and Part B benefits for support purposes, based on basic differences in Congress' express directions regarding the tax treatment of Part A and Part B financing and benefits. But Rev. Rul. 70-341 does not rest on this basis alone; we turn then to a close examination of its further premise that Part A benefits were intended to be, and are, social insurance benefits like Title II OASDI social insurance.

10/ (Continued)

retains substantial incidents of ownership over the policy, and receipt of the insurance proceeds by the beneficiary is contingent. E.g., Miller v. Commissioner, P-H Memo T.C., par. 59,155 (1959); Sauer v. Commissioner, P-H Memo T.C., par. 53,394 (1953); Vance v. Commissioner, 36 T.C. 547, 550 (1961). Of course, if the policy matures and the policyholder irrevocably transfers the proceeds to the dependent, such proceeds would then constitute support furnished by the policyholder.

Prior to amendment of Section 213 in Section 106 of the Social Security Amendments Act of 1965, 79 Stat. 286, medical insurance premiums were currently deductible under Code Section 213(a), and includible as support pursuant to Regulations Section 1.152-1(a)(2)(i) and Rev. Rul. 64-223, 1964-2 Cum. Bull. 50. Since the 1965 Social Security Amendments adding Code Section 213(e)(1)(C) expressly equated medical insurance premiums with payments for medical care, and medical care payments constitute support under Regulations Section 1.152-1(a)(2)(ii), Rev. Rul. 66-216, supra, concluded that medical insurance premiums and Part B premiums constituted support under Code Section 152. This conclusion represented the converse of the usual treatment of insurance premiums, and the medical insurance proceeds were thus excluded from the support computation.

E. The dissent below is correct in holding that Part A Basic Medicare benefits should be treated for tax purposes like Social Security OASDI and similar Government payments

Two incontestable facts stand out in the instant case. First, the $10,434.75 of Part A Medicare benefits which Mrs. Kavanaugh received were in fact used to pay for a portion of her support, as that term is used in Sections 151 and 152. See Treasury Regulations on Income Tax (1954 Code), § 1.152-1(a)(2)(i): "The term 'support' includes food, shelter, clothing, medical and dental care, education and the like." (Emphasis supplied.) Second, the parties agree that if the $10,434.75 of Part A benefits are treated as having been paid by Mrs. Kavanaugh for her own support, then the taxpayers have not provided more than one half of her support in 1970.

In this light, the Government contends that the dissenters in the proceedings below were clearly right in limiting the question raised in this case to the elementary one: are Part A Medicare benefits financed under the Social Security Act properly attributable to the recipient. The dissenters found the prior Revenue Rulings and case law enumerated above (pp. 17-24) involving similar Government payments to be determinative, as does the Commissioner on appeal. More specifically, the benefits paid out under Part A of the Social Security Medicare program are clearly

similar in intent and effect to the social insurance OASDI benefits of Title II, which the Commissioner in Rev. Ruls. 57-344 and 64-222, supra, ruled should be attributed to the recipients, for purposes of determining "support."

1. The structure and legislative history of Medicare make clear that Basic Medicare benefits represent Government social insurance payments

The Part A Basic Medicare health payments are totally the product of a statutory program designed by Congress. It is therefore necessary to analyze closely the statute itself, together with its legislative history, to determine the intent and effect of Congress in enacting this statutory scheme. Cf. Lutter v. Commissioner, supra; United States v. Mississippi Chemical Corp., 405 U.S. 298 (1972). We submit that analysis of the legislative history and the statutes themselves will demonstrate that in Part A Basic Medicare, Congress intended to, and did in fact create, a program patterned after and more similar to the Title II OASDI social insurance system, rather than an individual or private medical insurance plan.

Although various Medicare-type programs had been introduced and debated in earlier Congresses (e.g., see 111 Cong. Rec., Part 6, p. 7227 (remarks of Rep. King)), the present statute originated in H.R. 1 (later H.R. 6675) of the 89th Cong., 1st Sess., in early 1965.

Contrary to the impression given by the Tax Court's concurring opinion (R. 76-77), this original bill encompassed the hospital costs generally covered by Part A, not the physician and other similar costs later covered by Part B.

The original bill was supported by the Administration and was closely modeled upon the Social Security Act Title II OASDI payroll tax and benefits insurance. The statute was generally described as providing "social insurance" -- that is, workers would pay for the old-age hospitalization costs during their working years, together with contributions from employers, and no payments would be required of the beneficiaries after retirement.[14] For example, Anthony J. Celebreeze, the then Secretary of Health, Education and Welfare testified concerning the Basic Medicare hospitalization plan that (House Executive Hearings, supra, pp. 3-4):

> It seems to us that this principle--the preference for the prevention of poverty--applies as well to providing protection against the high and unpredictable costs of hospital and related care as it does to the provision of regular cash benefits under social security.

14/ See House Executive Hearings before the Committee on Ways and Means on Medical Care for the Aged, 89th Cong., 1st Sess., pp. 2-9 (Statement of H.E.W. Secretary Celebreeze, et al.); accord, Senate Hearings before the Committee on Finance on Social Security, 89th Cong., 1st Sess., pp. 92-96 (Statement of then Secretary Celebreeze).

> The proposed program would follow the social security approach. People would contribute from earnings during their working years, when their incomes are highest, and have protection against the costs of hospital and related services after age 65 without having to pay contributions at the time when income is generally curtailed.
>
> The proposal is a necessary extension of the monthly cash benefits of social security; adding this protection to cash benefits is the only practical way that economic security can be furnished in old age. Monthly cash benefits alone cannot do the whole job.
>
> Such benefits can be effective in helping the elderly to meet the regular, recurring expenses of food, clothing, and shelter, but monthly cash benefits cannot practically be made high enough to meet the unbudgetable cost of expensive illness. For this purpose it is necessary to have an insurance program aimed directly at the cost of illness.

When H.R. 1 was first introduced, it was contemplated that private insurance companies would develop programs to pay for physician and other costs, and the bill would have given antitrust exemptions to groups of private carriers to provide such coverage.[15/]

The House minority, led by Congressman Byrnes of the Ways and Means Committee, was bitterly opposed to using the Social Security payroll tax and benefits device to finance old-age medical care, on the grounds that it might threaten the fiscal integrity of the Social Security fund,

15/ House Executive Hearings, supra, fn. 14, pp. 2-9.

be unduly difficult to modify to meet changed medical needs, and bestow a windfall on the affluent aged. Instead, the minority preferred a substitute bill, which consisted of a voluntary old-age medical insurance plan modeled after the high option federal employee plans, with over-65 individuals paying part of the premiums and the Government paying the rest out of general revenues. Private carriers would administer this plan.[16/]

As a compromise between the Administration and the Byrnes' plans, Chairman Wilbur Mills devised the present program. Hospitalization expenses, which were estimated to account for the greatest financial burden for the aged, would be financed by Social Security payments throughout the workers' lifetimes.[17/] Physicians' costs would be covered by the Part B supplementary plan, which would be voluntary, financed in part by premiums collected from the aged and in part by general revenues, and administered in large part by private carriers.[18/]

16/ See 111 Cong. Rec., Part 6, pp. 7219-7227 (remarks of Rep. Byrnes); id., p. 7400 (remarks of Rep. Battin); id., Part 12, p. 15805 (remarks of Sen. Ribicoff); id., pp. 15870, 15873 (remarks of Sen. Curtis).

17/ Id., Part 6, p. 7214 (remarks of Rep. Mills).

18/ Id., Part 6, p. 7228 (remarks of Rep. King).

In addition, a third program was added in order to make the plan more comprehensive, providing for greatly increased medical assistance to needy individuals, financed from general federal and state revenues and administered by the states. Id., Part 6, pp. 7216-7217 (statement of Chmn. Mills). This latter program is now embodied in Title XIX of the Social Security Act.

The majority's position was that it was more feasible to finance the huge hospital costs on a social insurance basis by payroll taxes on younger workers, rather than out of premiums paid by elderly persons or out of general taxes and revenues;[19] that many elderly would drop out of a Government-sponsored hospital care insurance plan if it was not compulsory (id., Part 6, p. 7239 (remarks of Rep. Ullman)); that Social Security financing of the major hospital costs -- on a social insurance basis throughout workers' lifetimes rather than through general revenue support for a Governmental insurance program -- would best maintain the peoples' "self respect and dignity;"[20] and that social insurance financing of hospital care "will make it possible for people to build insurance protection in their working years against the high cost of illness in their old age."[21] In addition, the majority believed

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19/ Id., pp. 7228-7229 (remarks of Chmn. Mills); id., p. 7361 (remarks of Rep. O'Neill); id., p. 7400 (remarks of Rep. Rostenkowski); id., p. 7406 (remarks of Rep. Lindsay).

20/ Id., Part 12, p. 15824 (remarks of Sen. Ribicoff); see id., Part 6, p. 7354 (remarks of Rep. Pirnie).

21/ Id., Part 6, p. 7356 (remarks of Rep. Roosevelt); see id., p. 7406 (remarks of Rep. Lindsay); id., Part 11, p. 15630 (remarks of Sen. Anderson); see Senate Hearings, supra, p. 93 (Statement of then H.E.W. Secretary Celebreeze).

that hospital costs could be actuarily determined more easily and thus would more readily lend themselves to long-term social insurance projections, while physicians' costs were more difficult to estimate and should thus be covered by a currently financed insurance plan.[22/]

Throughout the ensuing debates in both the House and the Senate, proponents and opponents alike agreed on one point: that Part A Basic Medicare represented social insurance and an extension of Social Security OASDI benefits, while Part B embodied the minority's concept of a voluntary health insurance program akin to private individual medical insurance.[23/] The social insurance feature of Part A was at

22/ Id., Part 6, p. 7238 (remarks of Rep. Ullman). There was also a strong belief in Congress that financing physicians fees through a voluntary, non-tax payment program would best insure against Government intrusion into the physician-patient relationship. E.g., id., p. 7214 (remarks of Chmn. Mills); id., p. 7244 (remarks of Rep. Secrest).

23/ E.g., 111 Cong. Rec., Part 6, pp. 7221-7222 (remarks of Rep. Byrnes); id., pp. 7227-7228 (remarks of Rep. King); id., p. 7235 (remarks of Rep. Karsten); id., p. 7353 (remarks of Rep. Langen); id., Part 12, p. 15801 (remarks of Sen. Ribicoff); id., Part 11, pp. 15601-15602 (remarks of Sen. Long); id., p. 15630 (remarks of Sen. Anderson); Part 6, p. 7360 (remarks of Rep. Rodino); id., p. 7363 (remarks of Rep. Sullivan); id., p. 7369 (remarks of Rep. Yates).

Robert I. Myers, the then Chief Actuary of the Social Security Administration and probably the most knowledgeable expert on the Medicare legislation, describes the social insurance character of Part A, as opposed to the individual insurance character of Part B, as follows (Myers, Medicare (1970), pp. 87-88):

(Continued)

the core of the debate between the majority and the minority. The minority argued that Social Security financing would be

23/ (Continued)

> The HI [Hospital Insurance (Part A)] program clearly meets the usual definitions of social insurance. HI can be characterized as a program that is administered by a government agency, that is financed by compulsory contributions (taxes) from the protected persons and their employers (except as to certain older persons at the start of the program, whose benefits are financed from general revenues), and that provides benefits as a matter of right, without any means or needs test, on the basis of satisfying specified eligibility conditions as to age and length of coverage.
>
> On the other hand, SMI [Supplementary Medical Insurance (Part B)] does not meet the usual definitions of social insurance, although it may be so categorized by some individuals. Perhaps a better way of designating the SMI program is to call it a voluntary individual insurance program with government subsidy that is underwritten and administered by the the government using private carriers to assist with the administration. SMI is a program under which each eligible individual elects, during specified enrollment periods, whether he wishes to participate and pay a premium in partial financial support of the program. If he so elects, then the federal government pays a matching amount equal to the enrollee's premium. SMI has some of the characteristics of social insurance, such as a broad pooling of the risk, administration by a government agency, and establishment by legislative action, but it lacks the compulsory participation basis that is one of the prime characteristics of social insurance. (Emphasis added.)

regressive;[24] that a Social Security based plan would be unduly rigid because young persons who will have paid Social Security taxes would be unwilling to allow benefit reductions;[25] that the social insurance model would be unfairly expensive since the rich as well as the poor would be entitled to full hospitalization benefits; that the hospital care tax would in effect put a ceiling on the amount of OASDI taxes and benefits which could be appropriated and provided in the future[26] and would imperil the fiscal integrity of Social Security;[27] that Social Security financing was unduly burdensome to small businessmen;[28] and that covering hospital care under Social Security would give those then over 65 a windfall.[29] By contrast, the minority claimed that its voluntary, currently

24/ 111 Cong. Rec., Part 6, pp. 7223, 7240-7241 (remarks of Rep. Byrnes); id., p. 7233 (remarks of Rep. Schneebeli); id., p. 7353 (remarks of Rep. Langen); id., p. 15878 (remarks of Rep. Edwards); id., Part 6, p. 7367 (remarks of Rep. Clancy); id., p. 7405 (remarks of Rep. Broyhill).

25/ Id., Part 6, p. 7223 (remarks of Rep. Byrnes); id., p. 7233 (remarks of Rep. Schneebeli); id., Part 12, pp. 15869-15870 (remarks of Sen. Curtis); id., p. 7366 (remarks of Rep. Barrett); id., Part 6, p. 7367 (remarks of Rep. Clancy).

26/ Id., Part 6, p. 7238 (remarks of Rep. Broyhill); id., Part 12, p. 15871 (remarks of Sen. Curtis); id., p. 15940 (remarks of Sen. Allott); id., Part 6, pp. 7365-7366 (remarks of Rep. Barrett).

27/ Id., Part 6, p. 7363 (remarks of Rep. Edwards); id., pp. 7403-7404 (remarks of Rep. Broyhill).

28/ Id., Part 6, p. 7241 (remarks of Rep. Betts); id., p. 7366 (remarks of Rep. Barrett); id., p. 7393 (remarks of Rep. Hall).

29/ Id., Part 12, p. 15871 (remarks of Sen. Curtis); id., Part 6, p. 7359 (remarks of Rep. Fuqua).

financed system would preserve "the insurance concept." (Id., Part 6, p. 7233 (remarks of Rep. Schneebeli)).

The majority bill as enacted by Congress thus provided two separate but coordinated programs designed to meet the medical needs of the elderly. Under new Title XVIII, Part A, recipients of Social Security OASDI and Railroad Retirement Act benefits would be entitled to payment (after certain deductibles) for inpatient hospital services, post-hospital extended care services, post-hospital home health services, and outpatient hospital diagnostic services. Social Security Act Secs. 1811, 1812, 1813 (42 U.S.C. §§ 1395c-1395e). Payments would be made from a Federal Hospital Trust Fund subsidized by payroll taxes on employers and employees. Social Security Act, Sec. 1817 (42 U.S.C. § 1395i). Under Section 321 of the 1965 Act, new payroll taxes were added to the Internal Revenue Code in order to finance the Hospital Fund.

The 1965 Act also added a new Title XVIII, Part B, to the Social Security Act. Section 1831, Social Security Act (42 U.S.C. § 1395j), established a "voluntary insurance program to provide medical insurance benefits" to all over age 65 who elected to enroll, "to be financed from premium payments by enrollees together with contributions from funds appropriated by the Federal Government." Section 1841 (42 U.S.C. § 1395t) establishes a separate

"Federal Supplementary Medical Insurance Trust Fund" from which the benefits were to be paid. Section 1837 (42 U.S.C. § 1395p) establishes time periods for enrolling in the insurance program. Section 1839 (42 U.S.C. § 1395r) sets forth the premium amounts. Section 1831 (42 U.S.C. § 1395k) provides the physicians and other benefits covered by the program. Section 1833 (42 U.S.C. § 13951) provides the Part B deductibles, and the percentage of reasonable charges covered by the Part B plan.

A new Part C of Title XVIII of the Social Security Act was also added by the bill for the purpose of providing certain technical definitions of terms used in Part A or B, or both.

2. The majority opinions below legally erred in attempting to divine the "nature" or "character" of Part A payments apart from the Congressional intent

The majority opinion below made no real attempt to analyze these detailed provisions, or the legislative history which underlies them. Instead, it took as its premise the Rev. Rul. 70-341 conclusion that Part B benefits should be treated like private medical insurance proceeds for support purposes, and then superficially concluded that the "nature of the payments made under the [Part A] Basic Medicare provisions" cannot be "distinguished." (R. 68.) The concurring opinion made a more detailed analysis of the 1968 Act and its legislative history, but summarily dismissed (R. 80-81) the distinction between the

social insurance basis of Part A and the current individual medical insurance pattern of Part B as merely the result of "the historical development of the legislation within Congress in 1965 and associated political exigencies * * * [which] does not obscure the insurance character" of both Parts A and B.

The members of Congress spent over a decade developing and debating various types of health programs, including the Parts A and B of Medicare, and engaged in hundreds of pages of vehement arguments over the pros and cons of a social insurance versus a government-supported individual insurance program in the instant legislation. They would indeed be surprised -- if not aghast -- at the ease with which the majority below glossed over the differences between the two types of plans and the Congressmen's repeated statements that Part A was identical in principle, purpose and structure with Title II OASDI social insurance.[30/] In effect, the Tax Court

30/ The concurring opinion states (R. 86, fn. 14) that "It is a mystery why * * * [the Commissioner] identifies Part A of Title XVIII with the [OASDI] Social Security cash benefits provided by Title II (rather than with Part B of Title XVIII)." The real mystery to us is why the Tax Court majority totally ignored the repeated statements of Secretary Celebreeze and members of Congress that Part A benefits represented an extension of the social insurance principles embodied in, and benefits provided by, Title II OASDI. Of course, as Rev. Rul. 70-341, supra, indicates, Part A is not a pension or annuity program. But that is because Congress determined that the medical needs of the aged could not be met with fixed monthly payments. See statement of then H.E.W. Secretary Celebreeze, supra, pp. 27-28; 111 Cong. Rec., Part 6, p. 7228 (remarks of Chmn. Mills). That does not alter the basic social insurance character of that Program.

majority analyzed Parts A and B as if they were contracts or programs established by private parties, attempting to divine their real "nature" (R. 68) or "character" (R. 80), rather than analyzing the Congressional intent and effect embodied in such legislation.

Even when dealing with private parties, the Commissioner is entitled, if he wishes, to take their contracts and writings at face value, and tax them accordingly -- he need not employ a substance over form analysis.[31] Here, where we are dealing with a program enacted into law by the National Legislature itself, the Commissioner is virtually bound to give effect to the form in which the programs are cast, and must not attempt to probe some "obscure[d]" inner "character" (R. 80), "nature" (R. 68), or substance. The form of Title XVIII, Part A, together with the virtually unanimous statements of the Congressional supporters and opponents, fully manifests that it is a social insurance plan like Title II OASDI. Under established, unrefuted tax principles, payments under social insurance programs constitute support furnished by the recipient for purposes of Code Sections 152 and 153. See pages 17-24,

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31/ E.g., National Investors Corp. v. Hoey, 144 F. 2d 466, 467 (C.A. 2, 1944); Redwing Carriers, Inc. v. Tomlinson, 399 F. 2d 652, 659, fn. 9 (C.A. 5, 1968); Commissioner v. Nat. Alfalfa Dehydrating, 417 U.S. 134, 148-149 (1974); W & W Fertilizer Corp. v. United States, Docket No. 17-74 (Ct. Cl., Dec. 17, 1975), Slip Op. 7-8.

supra. That Congress may have structured a social insurance program so that it may, to some judges, resemble private medical insurance is simply irrelevant for tax purposes.

The circumstances here are analogous to those in United States v. Mississippi Chemical Corp., 405 U.S. 298 (1972). There, a complex of federal statutes established and regulated a system of "Banks for Cooperatives," and required borrowers from such Banks, in addition to paying interest on loans, also to pay further amounts in proportion to such interest for non-dividend, largely nontransferable stock in the Bank. Taxpayer-borrowers claimed that such stock was largely worthless and in fact represented an additional interest charge, and attempted to deduct the stock payments under Code Section 163(a) (26 U.S.C.). The Supreme Court unanimously rejected this contention that Congress' statutory designation of the payments as stock purchases, and its corresponding complex statutory plan for capitalizing the Bank, must be given effect. The Court emphasized that in considering a federal statute, it would not engage in the type of substance-over-form analysis which we submit was conducted by the Tax Court majority below (405 U.S., pp. 311-312):

> The taxpayers and the Government each allege that the other is looking at form rather than substance. At some point, however, the form in which a transaction is cast must have considerable impact. Guterman, Substance v. Form in the Taxation of Personal and Business Transactions, N.Y.U. 20th Inst. on Fed. Tax. 951 (1962). Congress chose to make the taxpayers buy stock; Congress determined that the stock was worth $100 a share; and this stock was endowed with a long-term value. While Congress might have been able to achieve the same ends through additional interest payments, it chose the form of stock purchases. This form assures long-term commitment and has bearing on the tax consequences of the purchases.

The majority opinions below also fell into fundamental error in stressing so heavily the similarities between Parts A and B of Title XVIII, and virtually ignoring the real issue whether Congress intended Part A payments to constitute a form of social insurance payments like Title II OASDI insurance benefits and other Governmental payments. For unlike OASDI social insurance and similar benefits, which under settled authorities clearly constitute Governmental benefits deemed to represent support furnished by the recipients, the classification of Part B premiums and benefits for Sections 151 and 152 purposes is not patent or easy. For this reason, the Commissioner rightly examined the legislative history of Part B together with the statutory language and structure, and in Rev. Rul. 70-341, supra, gave effect thereto and determined that Part B payments thereunder should be

treated as medical insurance proceeds. This conclusion is in line with numerous expressions of Congressional intent that Part B was modeled after the federal employee joint federal-insured medical insurance program[32], and that Part B was designed to operate like private insurance policies and build upon the compulsory Part A basic hospital care coverage, just as private insurance and pension plans build upon the basic OASDI social insurance benefits[33].

Yet, obviously Part B, though like private medical insurance, has many features of a Government welfare program. As the concurring opinion points out (R. 87-88), the Government subsidy of Part B is so substantial that few knowledgeable persons would elect not to enroll; in fact, premiums are automatically withheld from

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32/ The Byrnes' bill, a portion of which was incorporated as Part B, was modeled after the federal employee group medical insurance program. 111 Cong. Rec., Part 6, p. 7220 (remarks of Rep. Byrnes); id., p. 7363 (remarks of Rep. Sullivan); id., p. 7400 (remarks of Rep. Battin).

The concurring opinion below intimates (R. 79), that both Parts A and B of Medicare were patterned after the federal employee health insurance program. The concurring opinion notes the statement of Rep. Mills (111 Cong. Rec., Part 6, p. 7213) that the financing of the federal-employee-modeled bill of Rep. Byrnes and H.R. 6675 were substantially similar. We submit, however, that a fair reading of the character and purposes of Rep. Byrnes' bill, in comparison with the H.R. 6675, will show marked differences in philosophy; administration, voluntariness, financing, and even coverage. Rep. Langen characterized Parts A and B as constituting "two separate and conflicting systems." (111 Cong. Rec., Part 6, p. 7353.)

33/ See page 28, supra.

Social Security and Railroad Retirement benefits unless the recipient expressly requests otherwise. Indeed, in enacting Part B, Congress raised OASDI Social Security benefits more than enough to pay the initial Part B premiums. H. Rep. No. 213, 89th Cong., 1st Sess. 38. And the Government contribution to the Part B plan has increased proportionally over the years, reaching $2,029,000,000 in fiscal 1974, as compared to premium payments in that year of $1,704,000,000.[34]

Since Part B Supplementary Medical Insurance has so many features of a Government social welfare program, it is no wonder that the majority opinions below incorrectly classified Part A Basic Medicare when they relied solely on Part B as a standard of comparison. It is as if a casual observer had attempted to classify a shark by comparing it to a dolphin: the dolphin being a somewhat unusual species of mammal, the observer would likely incorrectly classify the shark as a mammal.[35]

34/ 1975 Ann. Rep. of the Bd. of Trustees of the Fed. Supplementary Medical Insurance Trust Fund, H. Doc. No. 94-137, 94th Cong., 1st Sess., p. 4.

35/ Compare the fable of the three blind men and the elephant discussed in the dissenting opinion of Judge Godbold in Mississippi Chemical Corp. v. United States, 431 F. 2d 1320, 1326, 1327, 1335-1336 (C.A. 5, 1970), the substance of which opinion was implicitly adopted in the reversal opinion of the Supreme Court, United States v. Mississippi Chemical Corp., 405 U.S. 298 (1972).

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3. The Part A Basic Medicare is more like Title II OASDI insurance than Part B Supplementary Insurance

In their efforts to equate Part A Basic Medicare with Part B Supplementary Insurance, the majority opinions below glossed over the differences in the essential features of the two plans, and concentrated on similarities in technicalities. They gave virtually no significance to the fact that the 1965 Social Security amendments expressly amended Section 213 of the Internal Revenue Code to allow a medical expense deduction for Part B premiums, like private medical insurance premiums. See 1965 Act, Sec. 106. At the same time, the 1965 legislation provided that Part A Basic Medicare would be financed by additional Social Security payroll taxes (Internal Revenue Code, Secs. 1401(b), 3101(b), 3111(b) (26 U.S.C.)), which could not be deducted. 1965 Act, Sec. 321(a); see H. Rep. No. 213, 89th Cong., 1st Sess., p. 179 (1965-2 Cum. Bull. 733, 745). The majority's rationale (R. 70) that "there is no necessary correlation between section 213 and sections 151 and 152" begs the

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35/ (Continued)

Of course, even if the Commissioner erred in treating Part B benefits as medical insurance proceeds, rather than ordinary Governmental benefits, for Code Sections 151-152 purposes, such error would not assist taxpayers. It would simply mean that both Part A and Part B benefits must be attributable to the recipient for purposes of Code Sections 151 and 152.

question, since Congress can make any payment deductible or not as it sees fit. The essential point is that deductibility of Part B premiums and nondeductibility of Part A taxes exactly accord with Congressional statements that Part A benefits constitute social insurance like OASDI, while Part B benefits are like private individual medical insurance benefits. That being the case, Part A benefits must be attributed to the recipient under settled Sections 151-152 tax principles.

Similarly, the concurring opinion does not explain (see R. 80) the obvious Congressional care in separating completely the Part A Federal Hospital Trust (SSA, Sec. 1817(a)) from the Part B Federal Supplementary Medical Insurance Trust Fund (SSA, Sec. 1841(a)), together with their governance (SSA, Secs. 1817(b), 1841(b)) and administration (SSA, Secs. 1817(b)-(h), 1841(b)-(h)). Instead, as explained above, pp. 35-40, the concurring opinion mistakenly passes off this important separation as an "historical development of the legislation within Congress in 1965 and associated political exigencies * * *" (R. 80).

The concurring opinion likewise errs (R. 78-79) in concluding that Part A is a part of an individual medical insurance plan because most private medical insurance plans contain hospitalization as well as physician service coverage.

Initially, we know of no private medical insurance plan which insists on or limits enrollment periods only for physician services coverage -- an important aspect of Part B Supplementary Insurance (SSA, Sec. 1837; 111 Cong. Rec., Part 12, p. 15803 (remarks of Sen. Ribicoff)). In any event, this rationale ignores once again the Congressional intent and language. Many insurance plans contain both income maintenance and medical coverage, but that fact does not transform OASDI social insurance into individual insurance for tax purposes. Indeed, the Congressional intent was to provide Basic Medicare as compulsory social insurance -- like OASDI -- and then give citizens a choice of building on that basic coverage with either Part B Supplementary Insurance or private supplementary coverage. See p. 28, supra, 111 Cong. Rec., Part 6, p. 7244 (remarks of Rep. Secrest). Senator Javits in fact expressed the view that private carriers might be able to take over operation of the entire Supplementary Plan.[36] 111 Cong. Rec., Part 12, p. 15796.

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[36] The actuarial bases for Parts A and B are substantially different. In general, Part A -- like OASDI -- is based on long-term projections of taxes to be collected and benefits to be paid out, while Part B is based on much more short-term actuarial figures. See 1975 Ann. Rep. of the Bd. of Trustees of the Fed. Hospital Insurance Fund; H. Doc. No. 94-136, 94th Cong., 1st Sess., p. 14; 1975 Ann. Rep. of the Bd. of Trustees of the Fed. Supplementary Insurance Trust Fund, supra, p. 9.

The concurring opinion is misleading in stating (R. 79-80) that under both Parts A and B "claims administration was delegated to private insurance companies (carriers and fiscal intermediaries)." In actuality, Part A provides for the use of fiscal intermediaries which

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The concurring opinion stresses (R. 84-85) that Title II OASDI benefits vary from insured to insured, depending on his length of covered employment and earnings, while Part A Medicare benefits contain no such entitlement fluctuations. Of course, even the concurring judges are immediately obliged to concede that the OASDI "benefit formula is weighted, a minimum benefit is provided, and benefits are provided for certain dependent relatives * * * to insure social adequacy." In any event, as a practical matter, it would have been extremely difficult to establish a minimum benefit level for Part A Basic Medicare similar to OASDI, since the level of benefits provided to all was considered minimal, and in dealing with hospital care it is extraordinarily difficult, as a practical

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35/ (Continued)

would generally determine the cost of hospital care, and transmit appropriate compensation to the hospital. On the other hand, Part B authorizes virtually total administration of the supplementary benefits plan by private insurance carriers (not just fiscal intermediaries) and reimburses the physician or patient on the basis of prevailing regional charges. See H. Rep. No. 213, 89th Cong., 1st Sess., pp. 45-47. 111 Cong. Rec., Part 6, p. 7228 (remarks of Rep. King); (remarks of Rep. Secrest): id., Part 12, p. 15803 (remarks of Sen. Ribicoff). Compare 20 C.F.R. §§ 405.651-405.659 (fiscal intermediaries) with 20 C.F.R. §§ 405.670-405.678 (private insurance carriers).

matter, to set arbitrary cut-off limits.[37] Indeed, one of the most important purposes of Part A was to give all recipients as full a coverage as possible, to preclude the hospitalized aged from having to turn to welfare programs for assistance.[38] In any event, the decision whether to grant uniform or fluctuating medical benefits under a social insurance plan is a decision for Congress; that uniform benefits were chosen does not detract from the social insurance character of Part A.[39]

37/ For example, the question whether to limit hospitalization coverage under Part A at all -- specifically to 120 days -- was hotly debated in the Senate. E.g., 111 Cong. Rec., Part 12, pp. 15802, 15807-15809, 15821-15825 (remarks of Sen. Ribicoff); id., pp. 15822-15823 (remarks of Sen. Long); id., pp. 15824-15825 (remarks of Sen. Miller); id., pp. 15806-15807 (remarks of Sen. Douglas); id., pp. 15808-15809 (remarks of Sen. Pull); id., p. 15833 (remarks of Sen. Mansfield); id., pp. 15834-15835 (remarks of Sen. Javits); id., p. 15834 (remarks of Sen. Gore).

38/ E.g., 111 Cong. Rec., Part 6, p. 7239 (remarks of Rep. Ullman); Executive Hearings, supra, p. 3 (Statement of H.E.W. Secretary Celebreeze). Prior to Medicare, 60 percent of all the aged receiving public assistance did so because of high medical costs. Ibid.

39/ As in the case of all extensions of OASDI benefits, Part A Basic Medicare was extended to all those currently on the Social Security rolls, even though corresponding contributions had not been made. H. Rep. No. 213, 89th Cong., 1st Sess., p. 21. Nor is it material here, as contended by the concurring opinion (R. 85) that Congress in 1974 -- after the year in issue -- determined to extend Part A benefits to persons making a fixed monthly payment. The tax treatment of such payments, and the benefits paid to those in respect of whom the payment is made, is not before the court.

The concurring opinion chastises (R. 77-78, 81) the Commissioner for failing to consider the definitions in Part C of Title XVIII which are made applicable to both Parts A and B, and to deduce that such commonality evidences the fact that Part A and B cannot be separated. Such deduction is simply wrong here, however, in the face of the overwhelming Congressional intent discussed above to enact two separate plans; a Part A social insurance plan, and a Part B Government-sponsored individual insurance plan, albeit both plans are closely coordinated in design and administration. In any event, the concurring opinion, while emphasizing common definitions, totally fails to mention that major portions of the 1965 Act add provisions to Title II (OASDI) of the Social Security Act, as well as adding provisions to the Social Security tax provisions of the Internal Revenue Code.[40/] Of equal importance, Section 1872 of the Social Security Act (42 U.S.C. § 1395ii), added by the 1965 Act, specifically incorporates numerous Title II OASDI provisions into Title XVIII. These provisions thus affirm the Congressional intent to enact Part A Basic Medicare as a social insurance plan, like Title II OASDI,

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40/ Section 101 of the Act, which deals only with Basic Medicare, adds Section 226 to Title II of the Social Security Act. Section 321(a) of the 1965 Act adds the payroll tax for Part A Basic Medicare to the Internal Revenue Code provisions (Sections 1401, 3101, 3111) which also provide for the OASDI payroll taxes.

rather than as a Government-sponsored individual insurance plan like Part B.

Finally, the concurring opinion (R. 83-84) mistakenly focuses on the need or social welfare factor in the precedents, and argues that Part A applies to rich and poor alike. Of course, the same is true of most Title II OASDI benefits, together with other Government benefits (such as GI Bill payments) which are granted all, regardless of need, yet which are clearly deemed support furnished by the recipients. The concurring opinion is obviously wrong in implying (R. 82) that the Government's position is that Part A Medicare is solely like welfare benefits; Rev. Rul. 70-341, supra, mentions the "social welfare" aspect of Medicare only to demonstrate that Part A payments are not taxable income, not in order to determine their status for support purposes.

F. The Commissioner's consistent Rulings--that payments under Government social insurance and assistance programs constitute support furnished by the recipients--constitute reasonable interpretations of Code Sections 151 and 152

Neither the taxpayers nor the Tax Court majority appear to dispute the numerous Rulings and cases set forth above, pp. 17-25, that payments under Government social insurance (e.g., OASDI) and assistance (e.g., GI Bill, AFDC) programs constitute support furnished by the recipients. Indeed, taxpayers do not contend that

the $1,148 received by Mrs. Kavanaugh in OASDI social insurance benefits should not be counted as support furnished by Mrs. Kavanaugh. Since the Government's entire case here rests on this tax premise, however, and since the matter is of such broad application and extraordinary importance, we believe it advisable to discuss the point briefly.

The Commissioner's long-standing interpretation of Sections 151 and 152 of the Code, as announced in the Treasury Regulations and Revenue Rulings cited above, pp. 17-25, and as approved in judicial decisions -- that all receipts which have been used for an individual's support must be attributed to that individual in determining whether he, rather than some other person, has provided a majority of his support, and is thus entitled to a dependency exemption -- is a reasonable interpretation of the language and intent of Code Sections 151 and 152. The Commissioner's allocation of federal payments to the recipient's own support, which originated in the Special Ruling, March 14, 1945, 1945 C.C.H. Stand. Fed. Tax Rep., par. 6168, has been followed uniformly since 1945.

Indeed, Congress may be said to have approved the Commissioner's interpretation of the "support" provision here in issue, both inferentially, by his 1954 enactment of Section 152(d), and by reenactment of the predecessor of Section 152(a). Upon reenactment of the substantive provisions under consideration in this case in the

Internal Revenue Code of 1954, the Congress at the same time added an additional $600 exemption in particular circumstances for children of the taxpayer who were students at an educational institution. See Section 151(e) of the Code. More to the point, however, the Congress added a provision which expressly ruled that, in determining whether the taxpayer provided more than one-half of such child's support, as required by Section 151(e)(1) and Section 152, "amounts received as scholarships for study at an educational institution * * * shall not be taken into account in determining whether such individual received more than half of his support from the taxpayer." Section 152(d) of the Code (26 U.S.C.).[41/] Thus, in one instance the Congress was willing to ignore one form of support provided by one not claiming a dependency exemption because the Congress in its wisdom determined that citizens in that situation deserved to retain a dependency exemption despite this additional support to the dependent. Moreover, the Congress even in this situation was unwilling to permit all scholarships to be excluded from the support computation, since it deliberately omitted from its beneficence all amounts received as tuition and subsistence payments under

41/ This provision excluding consideration of the value of scholarships in applying the support test was added because "a taxpayer who is sending his child through college, even with the help of a scholarship, is likely to be incurring more expenses for the child than is true in the case of taxpayers with dependents not in college." H. Rep. No. 1337, 83d Cong., 2d Sess., p. 19 (3 U.S.C. Cong. & Adm. News (1954), pp. 4017, 4043.

the provisions of the Servicemen's Readjustment Act of 1944, c. 268, 58 Stat. 284 (the GI Bill). See H. Rep. No. 1337, 83d Cong., 2d Sess., p. A43 (3 U.S.C. Cong. & Adm. News (1954), 4017, 4180); S. Rep. No. 1622, 83d Cong., 2d Sess., p. 195 (3 U.S.C. Cong. & Adm. News (1954), pp. 4621, 4830.) Here, we have one clear instance where the Congress determined that a federal governmental payment to a recipient was to be included in the support computation. Indeed, the parallels between the Part A Medicare benefits, which are financed by social security taxes paid during the taxpayer's working life, and the GI Bill benefits, which are conferred upon those who have served in the United States military forces for a period of time, is evident, and the Government submits, controlling.

The consistent treatment which the Commissioner has accorded federal payments, coupled with the reenactment of the underlying statute by Congress in 1954 without substantial change and in circumstances indicating approval of the Commissioner's interpretation gives great weight to the administrative interpretation promulgated by the Commissioner in Rev. Rul. 70-341, supra. See Corn Products Co. v. Commissioner, 350 U.S. 46, 52-53 (1955). Since, as shown above, Part A Basic Medicare was intended, and is, a form of social insurance benefits, and social insurance benefits are clearly support furnished by the recipient, the Commissioner's interpretation of the "support" requirement in Sections 151 and 152

of the Code should not be overturned by this Court, insofar as Rev. Rul. 70-341's consideration of the Part A Medicare benefits here involved is concerned. See Commissioner v. South Texas Co., 333 U.S. 496 (1948); United States v. Cartwright, 411 U.S. 546 (1973); and B. Forman Co. v. Commissioner, 453 F. 2d 1144 (C.A. 2, 1972), cert. denied, 407 U.S. 934 (1972), rehearing der d, 409 U.S. 899 (1972).

CONCLUSION

For the reasons stated, the decision of the Tax Court should be reversed.

Respectfully submitted,

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MARCH, 1976.

CERTIFICATE OF SERVICE

It is hereby certified that service of this brief has been made on the appellees, appearing pro se, by mailing four copies thereof on this 31st day of March, 1976, in an envelope, with postage prepaid, properly addressed to them as follows:

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APPENDIX A

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 151. ALLOWANCE OF DEDUCTIONS FOR PERSONAL EXEMPTIONS.

(a) Allowance of Deductions.--In the case of an individual, the exemptions provided by this section shall be allowed as deductions in computing taxable income.

* * *

(e) Additional Exemption for Dependents.--

(1) [as amended by Sec. 801(a)(1), Tax Reform Act of 1969, P.L. 91-172, 83 Stat. 487] In general.--An exemption of $625 for each dependent (as defined in section 152)--

(A) whose gross income for the calendar year in which the taxable year of the taxpayer begins is less than $625 or

(B) who is a child of the taxpayer and who (i) has not attained the age of 19 at the close of the calendar year in which the taxable year of the taxpayer begins, or (ii) is a student.

* * *

SEC. 152. DEPENDENT DEFINED.

(a) [as amended by Sec. [1](b), Act of August 31, 1967, P.L. 90-78, 81 Stat. 191] General Definition.--For purposes of this subtitle, the term 'dependent' means any of the following individuals over half of whose support, for the calendar year in which the taxable year of the taxpayer begins, was received from the taxpayer (or is treated under subsection (c) or (e) as received from the taxpayer):

* * *

(4) The father or mother of the taxpayer, or an ancestor of either,

* * *

(8) A son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law of the taxpayer,

* * *

SEC. 213. MEDICAL, DENTAL, ETC., EXPENSES.

(a) [as amended by Sec. 106(a), Social Security Amendments of 1965, P.L. 89-97, 79 Stat. 286] Allowance of Deduction.--There shall be allowed as a deduction the following amounts, not compensated for by insurance or otherwise--

(1) the amount by which the amount of the expenses paid during the taxable year (reduced by any amount deductible under paragraph (2)) for medical care of the taxpayer, his spouse, and dependents (as defined in section 152) exceeds 3 percent of the adjusted gross income, and

(2) an amount (not in excess of $150) equal to one-half of the expenses paid during the taxable year for insurance which constitutes medical care for the taxpayer, his spouse, and dependents.

* * *

(e) [as amended by Sec. 106(c), Social Security Amendments of 1965, P.L. 89-97, 79 Stat. 286] Definitions.--For purposes of this section--

(1) The term "medical care" means amounts paid--

* * *

(C) for insurance (including amounts paid as premiums under part B of title XVIII of the Social Security Act, relating to supplementary medical insurance for the aged) covering medical care referred to in subparagraphs (A) and (B).

* * *

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.):

§ 1.152-1 General definition of a dependent.

* * *

(2)(i) For purposes of determining whether or not an individual received, for a given calendar year, over half of his support from the taxpayer, there shall be taken into account the amount of support received from the taxpayer as compared to the entire amount of support which the individual received from all sources, including support which the individual himself supplied. The term "support" includes food, shelter, clothing, medical and dental care, education, and the like. Generally, the amount of an item of support will be the amount of expense incurred by the one furnishing such item. If the item of support furnished an individual is in the form of property or lodging, it will be necessary to measure the amount of such item of support in terms of its fair market value.

(ii) In computing the amount which is contributed for the support of an individual, there must be included any amount which is contributed by such individual for his own support, including income which is ordinarily excludable from gross income, such as benefits received under the Social Security Act (42 U.S.C. ch. 7). For example, a father receives $800 social security benefits, $400 interest, and $1,000 from his son during 1955, all of which sums represent his sole support during that year. The fact that the social security benefits of $800 are not includible in the father's gross income does not prevent such amount from entering into the computation of the total amount contributed for the father's support. Consequently, since the son's contribution of $1,000 was less than one-half of the father's support ($2,200) he may not claim his father as a dependent.

* * *

APPENDIX B

Special Ruling, March 14, 1945, 1945 C.C.H. Stand. Fed. Tax Rep., par. 6168:

[Following is the text of a letter dated March 14, 1945, and signed by Joseph D. Nunan, Jr, Commissioner:]

Reference is made to your letter of February 13, 1945, in which you request to be advised, inasmuch as the family allowance paid by the Government to the wife and dependents of a serviceman does not represent taxable income, whether such allowance must be taken into consideration in determining whether the wife is entitled to a surtax exemption or exemptions for a child or children. If the answer is yes, you inquire as to the amount of her own funds which the wife will be required to contribute toward the support of a child before she furnishes more than one-half of the support.

It is provided under the terms of the Servicemen's Dependents Allowance Act of 1942, as amended, 56 Stat. 381, 37 U.S.C.A. section 201 et seq., that a monthly family allowance shall be granted and paid by the United States to certain dependents of an enlisted man. The amount of such monthly family allowance in the case of a wife but no child shall be $50.00; a wife and one child $3000, with an additional $20.00 for each additional child. It is further provided that for any month for which such monthly family allowance is paid the monthly pay of such enlisted man shall be reduced by, or charged with, the amount of $22.00. The balance consists of the Government's contribution to such allowance. The Bureau has taken the position that the Government's contribution to the monthly family allowance is not taxable income, but that the amount charged to the pay of an enlisted man is includible in his gross income to the same extent as if paid directly to him. (I.T. 3574, C. B. 1942-2, page 52).

A dependent within the meaning of section 25(b) of the Internal Revenue Code, as amended by the Individual Income Tax Act of 1944, is a person having a gross income of less than $500.00 for the calendar year in which the taxable year of the taxpayer begins, who receives from the taxpayer during such calendar year more

than one-half of his support, and is related to the taxpayer within specified degrees of relationship. A child of the taxpayer is within the required degree of relationship.

The nature of the income, whether taxable or nontaxable, has no bearing in determining who furnishes the major portion of the support. Section 29.25-3 of Regulations 111 provides in part "Whether or not over half of a person's support, for the calendar year in which the taxable year of the taxpayer begins, was received from the taxpayer, shall be determined by reference to the amount of expense incurred by the taxpayer for such support."

In the case of a child who is not liable for the filing of a return, the mother is entitled to a surtax exemption of $500.00 for such dependent child if she contributes from her own funds for his support more than half of such support after taking into consideration the amount of the allowance provided by the Government, that is, the $30.00 a month with respect to the first child and the $20.00 a month with respect to an additional child.